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Land Improvement Tax Deductions

Use and Value to the Farm Sector

Arthur B. Daugherty

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LAND IMPROVEMENT TAX DEDUCTIONS: USE AND VALUE TO THE FARM SECTOR. Arthur B. Daugherty, Natural Resource Economics Division, Economic Research Service, U.S. Department of Agriculture. Staff Report AGES861210.

ABSTRACT

Of nearly 2.7 million farm sole proprietors filing tax returns in 1982, just 97,018 (4 percent) deducted soil and water conservation expenses and only 61,829 (2 percent) deducted land-clearing expenses. Each of these deductions averaged less than \$1,100 per return on which they were claimed. Average tax savings were estimated to be from \$177 to \$246 for farmers claiming conservation expense deductions and from \$220 to \$280 for those deducting land-clearing expenses. Although of considerable importance to individuals, these land improvement tax deductions were of minor importance to the farm sector, especially when contrasted to other tax provisions, such as the investment credit.

Keywords: Conservation, income taxes, land improvement, resource development, natural resources.

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SUMMARY

Soil and water conservation expense and land-clearing expense deductions were claimed on about 4 percent and 2 percent, respectively, of farm sole proprietor tax returns in 1982. Both types of deductions averaged less than \$1,100 per return. Estimated tax savings from these investments, each treated as the marginal (last) deduction, ranged from \$0 to \$1,800 per return for conservation deductions and \$0 to \$1,826 for land-clearing deductions. Average estimated tax savings for the farm sole proprietors claiming the deductions, across all taxable income classes, were from \$177 to \$246 for conservation expenses and from \$220 to \$280 for land-clearing deductions. Although these deductions combined totaled nearly \$170 million and were estimated to result in aggregate tax savings of from \$26.7 million to \$36.9 million, they paled in comparison to such farm tax deductions as interest, depreciation, and the investment tax credit.

Since tax rates declined annually from 1982 to 1984, estimated tax savings from equivalent expensing of land improvements would be less in years since 1982. Based on 1984 tax rates--the most recent year using the same taxable income classes as 1982--equivalent deductions would have resulted in estimated tax savings of from \$154 to \$221 for conservation expensing and from \$190 to \$250 for land-clearing expenses of farm sole proprietors claiming the deductions. Distributed across all farm sole proprietors on an annual basis, this would be tax savings of from less than \$6 to about \$8 for conservation deductions and from \$4 to \$6 for land-clearing expense deductions per farmer per year.

The Tax Reform Act of 1986 imposes some constraints on deductible soil and water conservation investments and repeals the land-clearing expense deduction. However, due to the other tax changes being effected simultaneously, it is not possible to estimate the impact of changes in the expensing of land improvement investments on the average farmer or on aggregate farm taxes.

Land Improvement Tax Deductions

Use and Value to the Farm Sector

Arthur B. Daugherty

INTRODUCTION

[Tax deductions for land improvements are often cited as being important incentives for adoption of soil and water conservation measures and for the conversion of land use to crop production. The Tax Reform Act of 1986 revises somewhat the deductible expenditures for soil and water conservation and eliminates the deduction for land-clearing expenditures incurred for the development of farmland (6). ^{1/} This paper analyzes the recent use and estimated tax savings from expensing soil and water conservation and land-clearing investments as a first step in evaluating the impacts of tax reform on landowners and on investments in the land resource. ^{2/}]

The analysis is based on special tabulations of farm sole proprietor tax returns for 1982 prepared by the Internal Revenue Service. The data were supplied in summary form for analysis of farm tax policies and as a supplemental data source on the farm sector (4, 7). Data representing nearly 2.7 million farm sole proprietors were summarized and cross-tabulated by various characteristics of the farm operation and/or the taxpaying unit. Only two-way classifications of data in tabular form were generally available. Since no individual taxpayer data were available, it was not possible to reconstruct complex profiles of groups of taxpayers. Had more detailed data been available, more precise estimates of the tax benefits of investments in land improvements would have been possible using the Land Improvement Tax Simulator (3).

LAND IMPROVEMENT EXPENSING

Tax deductions for soil and water conservation expenses and for land-clearing expenses were claimed by 97,018 and 61,829 farm sole proprietors, respectively, in 1982. Thus, less than 4 percent of all farm sole proprietors claimed conservation expense deductions (table 1) and only about 2 percent deducted land-clearing expenses (table 2). The following sections compare the distributions of farm sole proprietors claiming land improvement expense deductions with all farm sole proprietors by type of farm, by farm business receipts classes, and by taxable income classes.

^{1/} Underscored numbers in parentheses refer to sources cited in the References section.

^{2/} Other tax deductible expenditures might be considered land improvements, but soil and water conservation and land clearing are the only deductible expenses for investment in the land resource that appear separately on the farm tax form (Schedule F).

Table 1--Soil and water conservation expense tax deductions by farm sole proprietors,
by type of farm, 1982 1/

Type of farm	Soil and water conservation expense tax deductions				
	Total tax returns	Returns	Farm taxpayers taking deduction	Conservation deductions	Deduction per return
	-----Number-----		Percent	1,000 dollars	Dollars
Field crop	1,234,189	47,564	4	51,088	1,074
Vegetable and melon	54,000	2/ 1,290	2/ 2	2/ 3,306	2/ 2,563
Fruit and tree nut	79,296	3,061	4	3,930	1,284
Horticultural specialty	9,694	2/ 491	2/ 5	2/ 52	2/ 106
Beef cattle feedlots	3,985	2/ 18	2/,3/	2/ 123	2/ 6,833
Beef cattle, except feedlots	720,355	25,512	4	30,546	1,197
Hogs, sheep, and goats	204,541	6,261	3	3,495	558
Dairy farms	179,340	9,416	5	8,748	929
Poultry and eggs	46,159	2/ 576	2/ 1	2/ 73	2/ 127
General livestock, except animal specialty	21,358	2/ 292	2/ 1	2/ 102	2/ 349
Animal specialty	63,704	444	1	322	725
Farms not allocable	75,101	2,093	3	1,583	756
Total	2,691,722	97,018	4	4/ 103,370	1,065

1/ Based on special tabulations prepared by the Internal Revenue Service.

2/ Estimate should be used with caution because of the small number of sample returns on which it was based.

3/ Less than 0.5 percent.

4/ Data by type of farm may not sum to total due to rounding.

Table 2--Land-clearing expense tax deductions by farm sole proprietors by type of farm, 1982 1/

Type of farm	Land-clearing expense tax deductions				
	Total tax returns	Returns	Farm taxpayers taking deduction	Clearing deductions	Deduction per return
	Number		Percent	1,000 dollars	Dollars
Field crop	1,234,189	26,116	2	30,740	1,177
Vegetable and melon	54,000	3,959	7	2,657	671
Fruit and tree nut	79,296	4,408	6	3,528	800
Horticultural specialty	9,694	0	0	0	0
Beef cattle feedlots	3,985	0	0	0	0
Beef cattle, except feedlots	720,355	14,084	2	16,712	1,187
Hogs, sheep, and goats	204,541	4,820	2	2,415	501
Dairy farms	179,340	4,835	3	6,184	1,279
Poultry and eggs	46,159	2/ 631	2/ 1	2/ 28	2/ 44
General livestock, except animal specialty	21,358	2/ 945	2/ 4	2/ 343	2/ 363
Animal specialty	63,704	2/ 13	2/ 3/	2/ 30	2/ 2,308
Farms not allocable	75,101	2,018	3	2,945	1,459
Total	2,691,722	61,829	2	4/ 65,581	1,061

1/ Based on special tabulations prepared by the Internal Revenue Service.

2/ Estimate should be used with caution because of the small number of sample returns on which it was based.

3/ Less than 0.5 percent.

4/ Data by type of farm may not sum to total due to rounding.

Deductions by Type of Farm

Nearly half the returns claiming deductions for soil and water conservation expenses were by field crop farmers (table 1). More than a quarter more were by operators of beef cattle farms other than feedlots. About 1 in 10 of the returns claiming soil and water conservation expense tax deductions were from dairy farmers who claimed these deductions more frequently than did any other type of farm proprietor. Even so, only slightly over 5 percent of dairy farmers deducted conservation expenses.

The soil and water conservation expense tax deductions totaled about \$103.4 million in 1982. As indicated in table 1, this was only about \$1,065 per return claiming the deduction. The three types of farms that accounted for 85 percent of the returns claiming the conservation deduction were each near the overall average in the amount claimed. Although there was considerable variation in the size of deduction by type of farm, the two highest values should be used with caution because of the small number of sample returns used in making the estimates. However, one of these--beef cattle feedlots, with the highest average deduction per taxpayer--deserves mentioning. Large conservation deductions by beef feedlot owners were possibly for manure management facilities to prevent runoff from the feedlots from entering and polluting surrounding watercourses.

Land-clearing expense tax deductions were claimed by only about 2 percent of farm sole proprietors in 1982 (table 2). As for the conservation expense deduction, the largest number of returns claiming a land-clearing deduction was from field crop, beef cattle (except feedlots), and dairy farms, respectively. For these types of farms, clearing owned land may be a cheaper way of expanding acreage than buying additional land.

Closely following dairy farms were farms specializing in hogs, sheep, and goats and in fruit and tree nuts. On a proportional basis, however, vegetable and melon farms and fruit and tree nut farms led with 7 and 6 percent of the returns, respectively, claiming a tax deduction for land-clearing expense. It is not known why a higher percentage of these latter two types of farms are clearing land, but one cause may be the development of new production areas. For example, many vegetable and citrus growers are moving farther south in Florida and developing new production areas, due largely to the recent severe freezes in historical producing areas of the State.

Land-clearing expense tax deductions in 1982 totaled nearly \$65.6 million. The average was \$1,061 per return. As with the conservation expense deduction, the largest deduction by type of farm--\$2,308 for animal specialty farms--should be used with caution due to the small number of sample returns on which it was based. Field crop, beef cattle (except feedlots), and dairy farms all reported deductions somewhat above the average. Proprietors of farms specializing in hogs, sheep, and goats; fruit and tree nuts; and vegetables and melons that reported considerable use of the deduction claimed clearing expenses well below the average per return.

Deductions by Class of Farm Business Receipts

The distribution of soil and water conservation expenses by farm business receipts classes is presented in table 3. Although the number of tax returns claiming the soil and water conservation expense deduction is generally larger for low farm receipts classes and smaller for high farm receipts classes, a

Table 3--Soil and water conservation expense tax deductions by farm sole proprietors,
by size of farm business receipts, 1982 1/

Farm business receipts	Soil and water conservation expense tax deductions				
	Total tax returns	Returns	Farm taxpayers taking deduction	Conservation deductions	Deduction per return
	Number		Percent	1,000 dollars	Dollars
No reported farm business receipts	226,987	3,987	2	1,754	440
Less than \$2,500	680,057	11,415	2	3,806	333
\$2,500 to \$4,999	306,131	8,772	3	5,522	630
\$5,000 to \$9,999	318,058	12,816	4	8,429	658
\$10,000 to \$24,999	369,834	13,463	4	10,237	760
\$25,000 to \$49,999	275,905	7,313	3	6,850	937
\$50,000 to \$99,999	268,291	21,376	8	18,457	863
\$100,000 to \$249,999	190,392	13,866	7	28,109	2,027
\$250,000 to \$499,999	39,751	2,931	7	15,778	5,383
\$500,000 to \$999,999	11,022	592	5	1,961	3,313
\$1,000,000 or more	5,294	487	9	2,467	5,066
Total	2,691,722	97,018	4	103,370	1,065

1/ Based on special tabulations prepared by the Internal Revenue Service.

higher proportion of farmers in high farm receipts classes tended to claim the deduction (table 3). The range was from 2 percent of the returns in the lowest farm receipts class to 9 percent in the highest class. The average size of the deduction followed closely the size pattern of farm receipts, at least up to \$500,000. Of the total conservation expense deductions, about 27 percent were claimed by taxpayers with farm business receipts of from \$100,000 to \$249,999. Over 60 percent of the conservation deductions were accounted for by returns with farm business receipts in the three classes between \$50,000 and \$500,000.

Although there is still considerable variation across farm receipts classes in the case of land-clearing deductions, there is much less variation for this deduction than for soil and water conservation expenses (table 4). Only 1 to 3 percent of the returns in each class claimed a land-clearing expense deduction up to the \$500,000 class. Also, the average deduction per return for each of the farm receipts classes less than \$500,000 was less than \$2,000. The highest two classes reported average deductions of \$5,128 and \$9,312 per return but due to the small numbers of taxpayers in these classes accounted for only a little over 6 percent of the total land-clearing expense deductions in 1982. A major portion of the aggregate deduction (83 percent) is distributed reasonably uniformly over the seven farm business receipts classes less than \$250,000.

Deductions by Taxable Income Classes

Nearly 41 percent of the conservation deductions were on returns with taxable incomes of \$3,400 or less (table 5). Other than this high proportion of conservation deductions on returns in the lowest taxable income class, there seems to be no clear relationship between the use and/or amount of this deduction and taxable income. However, about two-thirds of the aggregate deduction was taken on returns having taxable incomes of \$16,000 or less.

In the case of land-clearing expense, again, a high proportion of returns claiming the deduction (22 percent) were in the smallest taxable income class (table 6). These returns also accounted for a more than proportional 31 percent of the total land-clearing expense deductions by farm sole proprietors in 1982. Although the clearing deductions are less concentrated than the conservation deductions among the smaller taxable income classes, over half of both the returns claiming a land-clearing deduction and of the aggregate total amount deducted was by taxpayers with taxable incomes of \$16,000 or less. In general, however, there was no discernible pattern in the amount of deduction per return across taxable income classes.

TAX SAVINGS FROM LAND IMPROVEMENT EXPENSING

Estimates were made of the range in possible tax savings per return and in total from conservation expense deduction and from land-clearing expense deduction by taxable income class for 1982 (tables 5 and 6, respectively). These tax savings were estimated as if each of the land improvement deductions were the last deduction taken which reduced the taxpayer's taxable income to

Table 4--Land-clearing expense tax deductions by farm sole proprietors, by size of farm business receipts, 1982 1/

Farm business receipts	Total tax returns	Land-clearing expense tax deductions			
		Returns	Farm taxpayers taking deduction	Clearing deductions	Deduction per return
		Number	Percent	1,000 dollars	Dollars
No reported farm business receipts	226,987	5,351	2	4,795	896
Less than \$2,500	680,057	18,862	3	7,086	376
\$2,500 to \$4,999	306,131	7,920	3	9,871	1,246
\$5,000 to \$9,999	318,058	6,863	2	8,846	1,289
\$10,000 to \$24,999	369,834	5,211	1	5,853	1,123
\$25,000 to \$49,999	275,905	4,861	2	5,801	1,193
\$50,000 to \$99,999	268,291	5,410	2	9,194	1,699
\$100,000 to \$249,999	190,392	5,577	3	7,852	1,408
\$250,000 to \$499,999	39,751	1,065	3	2,070	1,944
\$500,000 to \$999,999	11,022	571	5	2,928	5,128
\$1,000,000 or more	5,294	138	3	1,285	9,312
Total	2,691,722	61,829	2	65,581	1,061

1/ Based on special tabulations prepared by the Internal Revenue Service.

Table 5—Soil and water conservation expense tax deductions by farm sole proprietors, by size of taxable income, 1982 1/

Taxable income class	:	Soil and water conservation expense tax deductions							
	:	Total							
	:	tax							
	:	returns	Returns	Conservation Deduction	Minimum	Maximum	Minimum	Maximum	
	:			deductions	tax savings	tax savings	total	total	
:				per	per	tax	tax		
:				return	return	savings	savings		
<hr/>									
	:		1,000						
	:	Number	dollars	Dollars			—1,000 dollars—		
	:								
Up to \$3,400	:	739,540	26,131	42,219	1,616	0	194	0	5,066
Over \$3,400 to \$5,500	:	163,337	5,423	1,497	276	33	39	180	210
Over \$5,500 to \$7,600	:	156,293	5,471	10,991	2,009	281	321	1,539	1,759
Over \$7,600 to \$11,900	:	328,582	12,050	3,736	310	50	59	598	710
Over \$11,900 to \$16,000	:	245,873	10,645	10,028	942	179	207	1,905	2,206
Over \$16,000 to \$20,200	:	253,472	10,776	5,397	501	110	125	1,187	1,349
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Over \$20,200 to \$24,600	:	220,902	6,346	6,747	1,063	266	308	1,687	1,957
Over \$24,600 to \$29,900	:	177,009	5,463	2,351	430	125	142	682	776
Over \$29,900 to \$35,200	:	119,273	2,569	1,305	508	168	198	431	509
Over \$35,200 to \$45,800	:	131,850	4,386	3,325	758	296	334	1,297	1,463
Over \$45,800 to \$60,000	:	64,876	2,896	3,286	1,135	499	556	1,446	1,610
Over \$60,000 to \$85,600	:	44,629	2,113	2,590	1,226	601	613	1,269	1,295
Over \$85,600	:	46,086	2,749	9,897	3,600	1,800	1,800	4,949	4,949
<hr/>									
Total	:	2,691,722	97,018	2/ 103,370	1,065	177	246	17,168	23,858

1/ Based on special tabulations prepared by the Internal Revenue Service.

2/ Data by taxable income class may not sum to total due to rounding.

Table 6—Land-clearing expense tax deductions by farm sole proprietors, by size of taxable income, 1982 1/

Taxable income class	:	Land-clearing expense tax deductions							
	:	Total							
	:	tax				Minimum	Maximum	Minimum	Maximum
	:	returns	Returns	Land-	Deduction	tax savings	tax savings	total	total
	:			clearing	per	per	per	tax	tax
:			deductions	return	return	return	savings	savings	
<hr/>									
:	:		1,000						
:	:	Number	dollars	Dollars			—1,000	dollars—	
:	:								
Less than \$3,400	:	739,540	13,909	20,127	1,447	0	174	0	2,415
Over \$3,400 to \$5,500	:	163,337	1,743	1,100	631	76	88	132	154
Over \$5,500 to \$7,600	:	156,293	3,069	5,174	1,686	236	270	724	828
Over \$7,600 to \$11,900	:	328,582	7,532	5,573	740	118	141	892	1,059
Over \$11,900 to \$16,000	:	245,873	7,358	3,979	541	103	119	756	875
Over \$16,000 to \$20,200	:	253,472	4,852	5,099	1,051	231	263	1,122	1,275
<hr/>									
Over \$20,200 to \$24,600	:	220,902	5,962	3,333	559	140	162	833	967
Over \$24,600 to \$29,900	:	177,009	4,095	1,951	476	138	157	566	644
Over \$29,900 to \$35,200	:	119,273	4,653	3,306	711	234	277	1,091	1,289
Over \$35,200 to \$45,800	:	131,850	3,466	1,570	453	177	199	612	691
Over \$45,800 to \$60,000	:	64,876	1,864	4,190	2,248	989	1,101	1,844	2,053
Over \$60,000 to \$85,600	:	44,629	1,507	5,504	3,652	1,790	1,826	2,697	2,752
Over \$85,600	:	46,086	1,819	4,675	2,570	1,285	1,285	2,338	2,338
<hr/>									
Total	:	2,691,722	61,829	65,581	1,061	220	280	13,606	17,339

1/ Based on special tabulations prepared by the Internal Revenue Service.

the classes shown 3/. The minimum tax savings estimated assumed the deduction reduced the taxable income to the low end of the class. The maximum tax savings assumed the deduction merely reduced the taxable income to the upper boundary of the taxable income class. For example, with a taxable income of over \$5,500 to \$7,600 a \$2,009 conservation expense deduction (table 5) would save ($\$2,009 \times 0.14$) or \$281 if this "last deduction" reduced the taxable income to anything less than \$5,591 ($\$7,600 - \$2,009$). The maximum value of the deduction would be ($\$2,009 \times 0.16$) or \$321 if the taxable income were exactly \$7,600 after this "last deduction."

The tax savings from equivalent land improvements made in years since 1982 would be smaller than estimated for 1982 due to the annual decrease in tax rates through 1984 and the indexing of taxable income class values beginning in 1985 (1, 2).

Tax Savings From Conservation Expense Deductions

The aggregate tax savings to taxpayers (or the tax cost to the government) from soil and water conservation expense deductions are estimated to be from \$17.2 to \$23.9 million based on the use of this tax deduction in 1982 and assuming married taxpayers filing joint returns (2, p. 36). These total tax savings (last two columns of table 5) were estimated as the product of the respective tax savings per return and the number of returns reporting the soil and water conservation expense deduction, rounded to thousands of dollars. On the average, the conservation deduction saved the individual farm sole proprietor claiming this deduction from \$177 to \$246. Considered in relation to all farm sole proprietors--as in any given year any of them might have this type deduction--the savings would range from a bit more than \$6 to somewhat less than \$9 per farm sole proprietor per year.

Based on 1984 tax rates--the most recent tax year using the same taxable income classes--equivalent conservation deductions would have produced estimated tax savings of only \$14.9 to \$21.5 million or from \$154 to \$221 per farm sole proprietor claiming the deduction. Annualized across all farm sole proprietors, the tax savings would be from less than \$6 to about \$8 per farm sole proprietor per year.

Tax Savings From Land-Clearing Expense Deductions

Land-clearing expense tax deductions were estimated to have saved individual farm sole proprietors up to \$1,826 in Federal income taxes in 1982 based on married taxpayers filing joint returns. On the average, however, the savings were estimated to range from \$220 to \$280 per return claiming the deduction (table 6). In the aggregate, this deduction was estimated to result in tax savings of from \$13.6 million to \$17.3 million. Considered on an annualized basis, this amounts to between \$5 and a bit over \$6 per farm sole proprietor per year.

3/ The tax savings estimated could be greater if each deduction were not considered the marginal deduction (last deduction taken). However, it is not possible from the tabular data available to determine how many or which returns had both soil and water conservation expense and land-clearing expense, if any. Therefore, it seemed preferable to consider each separately as the last deduction.

Again, based on 1984 tax rates, equivalent land-clearing deductions would have produced smaller estimated tax savings: \$11.8 to \$15.4 million or from \$190 to \$250 per farm sole proprietor claiming the deduction. Annualized across all farm sole proprietors, the tax savings would be between \$4 and \$6 per farm sole proprietor per year.

PROCEDURAL LIMITATIONS AND STUDY RESULTS

Of the two deductions considered here, the conservation deduction appears the most advantageous to a taxpayer. This deduction is limited to 25 percent of a taxpayer's gross income from farming, but undeducted expenses can be carried over indefinitely to future tax years. The deduction in any year, whether carried forward or made in the current tax year, is subject to the limit of 25 percent of gross farm income in the year deducted (1, p. 389). In contrast, land-clearing expense deductions are limited to 25 percent of taxable income derived from farming or \$5,000, whichever is less and undeducted amounts may not be carried forward to subsequent tax years (1, p. 390).

The concentration of farm sole proprietors claiming land improvement deductions and of the amount of the deductions in the lowest taxable income class might lead one to the conclusion that land improvement investments are being made most frequently by operators of "small" and/or "poor" farms. The picture changes considerably, however, if data on farm business receipts and other types of income are related to taxable income class (table 7). Farm sole proprietors in the lowest taxable income class in 1982 averaged about \$54,900 of farm business receipts. Thus, the lowest taxable income class had higher average gross receipts than the next 10 higher taxable income classes, exceeded only by the 2 highest taxable income classes. These taxpayers had much lower off-farm incomes, but when average off-farm and interest income were added to farm business receipts, the lowest taxable income class still exceeded the next six higher taxable income classes in the total of farm business receipts, off-farm income, and interest income before any deductions.

A considerable number of returns contained conservation and/or land-clearing expense deductions but had no reported farm business receipts. The apparent explanation for this is that these individuals rent out farms or farmland but these landlords materially participate in the farming operations on the land and as a result may report their income as "other" farm income on Schedule F rather than reporting it simply as rent in Part I of Schedule E (8, p. 8).

According to Reinsel (4), 65 percent of the nearly 2.7 million farm sole proprietors reported net farm losses in 1982. Although 1982 may not be representative in this respect, land-clearing expense would have no tax-saving value to a taxpayer with negative net farm income as that deduction is limited to 25 percent of the taxpayer's taxable income derived from farming and cannot be carried forward to future tax years. 4/

4/ From 1971 through 1980, the percentage of farm sole proprietors reporting farm losses ranged from 38.9 percent to 51.3 percent. In 8 of the 10 years, more than 45 percent reported farm losses (5, p. 36). Based on 1976 data, farm sole proprietors reporting losses also reported considerably more off-farm income, \$18,669 per return compared with \$8,245 per return for farm sole proprietors reporting farm profits (5, p. 38).

Table 7--Farm business receipts, off-farm income and interest income per farm sole proprietor, tax return, by taxable income class, 1982 1/

Taxable income class	:	Total	Farm	Off-	Interest	Total farm
	:	tax	business	farm	income	business receipts,
	:	returns	receipts	income	per	off-farm income,
	:		per tax	per tax	tax	and interest income
	:		return	return	return	per tax return
	:	Number	-----Dollars-----			
Up to \$3,400	:	739,540	54,903	1,366	2,120	58,388
Over \$3,400 to \$5,500	:	163,337	24,451	9,621	1,909	35,981
Over \$5,500 to \$7,600	:	156,293	27,742	12,015	2,161	41,918
Over \$7,600 to \$11,900	:	328,582	25,992	15,218	2,284	43,493
Over \$11,900 to \$16,000	:	245,873	23,799	19,756	2,408	45,963
Over \$16,000 to \$20,200	:	253,472	23,075	24,530	2,741	50,346
Over \$20,200 to \$24,600	:	220,902	22,520	29,412	3,659	55,591
Over \$24,600 to \$29,900	:	177,009	28,670	33,906	3,767	66,343
Over \$29,900 to \$35,200	:	119,273	36,396	40,476	5,240	82,112
Over \$35,200 to \$45,800	:	131,850	37,540	48,045	6,387	91,973
Over \$45,800 to \$60,000	:	64,876	44,917	62,909	11,581	119,407
Over \$60,000 to \$85,600	:	44,629	76,295	88,312	17,339	181,946
Over \$85,600	:	46,086	118,862	270,777	37,173	426,812
Total 2/	:	2,691,722	36,895	24,036	3,877	64,807

1/ Based on special tabulations prepared by the Internal Revenue Service.

2/ Columns may not sum to totals due to rounding.

Soil and water conservation tax deductions may be of value to farmers reporting net farm losses. Since conservation deductions are limited by gross, not taxable, farm income, they might contribute to a farm loss which in turn could be used to reduce income subject to tax from other sources. Conservation expenses which exceed 25 percent of a taxpayer's taxable income derived from farming may be carried forward to future tax years. As a result, conservation investments may depend as much or more on tax management as on the need for soil- and water-conserving measures.

A major criticism of the soil and water conservation deductions has been the "tax-sheltering" feature; that is, diverting off-farm income into investments that result in farm losses for tax purposes. The data for 1982 do not support the "tax-sheltering" argument. A high proportion of the farm sole proprietors reporting conservation expense deductions had low nonfarm incomes (table 7). At least for 1982, the soil and water conservation expensing provision does not appear to have attracted large amounts of nonfarm income into farm investments in soil and water conservation. Depending on other circumstances, the expenditures might produce larger tax savings if added to the cost basis of the property and used to reduce future capital gains than if they were deducted currently at an extremely low tax rate.

As further evidence of the relative importance of the conservation and land-clearing expense deductions from a tax policy viewpoint, these deductions were contrasted with other types of deductions claimed by farm sole proprietors in 1982. Interest expenses of \$13.4 billion were claimed on more than 1.4 million farm sole proprietor tax returns. Depreciation deductions of nearly \$15.6 billion were claimed on about 2.3 million returns. Even investment tax credit--which reduces tax on a dollar-for-dollar basis--was claimed by nearly 1 million farm sole proprietors and totaled more than \$1 billion. Depending on the taxpayer's marginal tax bracket, a dollar of tax credit may be worth from \$2 to more than \$8 of deductions. Thus, conservation and land-clearing expense deductions of \$0.1 billion and \$0.07 billion on 0.1 million and 0.06 million returns, respectively, seem of minor importance to the farm sector.

TAX REFORM ACT OF 1986

The Tax Reform Act of 1986 limits expensing of soil and water conservation investments "to those consistent with a conservation plan approved by the Soil Conservation Service of the Department of Agriculture or, in the absence of such a plan, a plan of a comparable State conservation agency (6, p. II-110)." The expenses for draining or filling wetlands or for land preparation for center pivot irrigation system installation are specifically not eligible for deduction under the special expensing provisions for soil and water conservation expenditures. Expenditures eligible for deduction include grading, terracing, contour farming, construction of drainage ditches, irrigation ditches, dams and ponds, and planting of windbreaks. The deduction limit is unchanged at 25 percent of the taxpayers' gross income from farming. The expensing of land-clearing expenditures was repealed by the Tax Reform Act of 1986 for expenditures made after December 31, 1985 (6, p. II-111).

Except for the loss of the land-clearing expense deduction for 1986, the effects of the changes in expensing of land improvements on farmers' Federal income taxes are impossible to predict. So many other changes, both positive and negative, are occurring simultaneously that the effects of being unable to expense certain land improvement expenditures cannot be determined.

Land improvement expenses no longer qualifying for deduction can be added to the basis of the property and serve to reduce capital gains when the property is sold. Since the Tax Reform Act of 1986 repealed preferential capital gains treatment (capital gains will be treated as ordinary income), an increase in basis of the property upon sale may be as valuable as or more valuable than a current deduction, depending on income in the year of the investment; income in the year of sale; and on the holding period between the investment and sale of the property (6, p. II-106). In any case, the effects of the new tax law on land improvement tax deductions should have a relatively minor impact on aggregate farm taxes.

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